

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Acting Chairman;
Nanci E. Langley, Vice Chairman;
Mark Acton; and
Tony Hammond

Changes Concerning Attributable Costing

Docket No. RM2016-13

NOTICE OF PROPOSED RULEMAKING
ON CHANGES CONCERNING ATTRIBUTABLE COSTING

(Issued September 9, 2016)

I. INTRODUCTION

The Commission initiates this rulemaking to request comments on proposed changes to title 39 of the Code of Federal Regulations (CFR) as they relate to attributable costs. The primary purpose of the rulemaking is to make conforming changes to rules that specifically define or describe attributable costs, pursuant to Commission Order No. 3506.¹

¹ Docket No. RM2016-2, Order Concerning United Parcel Service, Inc.'s Proposed Changes to Postal Service Costing Methodologies (UPS Proposals One, Two, and Three), September 9, 2016 (Order No. 3506).

II. BACKGROUND

In Docket No. RM2016-2, the Commission issued Order No. 3506 after consideration of a United Parcel Service, Inc. (UPS) Petition which sought to make changes to the methodologies employed by the Postal Service to account for the costs of its products in its periodic reports.² In Proposal One, UPS recommended that the Postal Service calculate and attribute inframarginal costs to individual products in addition to the currently attributed volume-variable and product-specific fixed costs.³

² Docket No. RM2016-2, Petition of United Parcel Service, Inc. for the Initiation of Proceedings to Make Changes to Postal Service Costing Methodologies, October 8, 2015 (Petition).

³ Petition, Proposal One at 1. Proposal Two dealt with reclassifying some fixed costs as fully or partially variable, and attributing those costs to products. *See generally*, Petition, Proposal Two at 1. UPS also filed a third proposal, which requested review of competitive products; share of institutional costs. Petition, Proposal Three at 1. In Order No. 2793, the Commission held consideration of Proposal Three in abeyance until the Commission completed its review of Proposals One and Two. Docket No. RM2016-2, Notice of Proposed Rulemaking on United Parcel Service, Inc.'s Proposed Changes to Postal Service Costing Methodologies (UPS Proposals One, Two, and Three), October 29, 2015, at 6-7 (Order No. 2793). It is the Commission's decision concerning Proposal One that initiated this proposed rulemaking.

Section 3633(a)(2) (competitive rate regulation) requires the Commission to ensure that “each competitive product covers its costs attributable.” 39 U.S.C. 3633(a)(2); *see also* 39 CFR 3015.7(b).⁴ Section 3631(b) defines attributable cost as “the direct and indirect postal costs attributable to [] product[s] through reliably identified causal relationships.” 39 U.S.C. 3631(b).

Additionally, under section 3622 (market dominant rate and class regulation), a product’s ability to cover its attributable costs is a factor to be considered when regulating rates for market dominant products and includes the same terminology, that postal costs should be attributed through reliably identified causal relationships, found in sections 3631(b). 39 U.S.C. 3622(c)(2).

Therefore, title 39 introduces the concept of attributable costs and describes the role they play in the regulation of both market dominant and competitive products. For competitive products, coverage of attributable costs is a requirement in regulating

⁴ This Notice of Proposed Rulemaking sets forth amendments to 39 CFR part 3015, which implements 39 U.S.C. 3633. These proposed rules are conforming changes required by the Commission’s action taken on the UPS Petition. *See* Order No. 3506 at 61-62, 123-124. (Adopting the use of incremental costs to calculate attributable cost). Uncodified section 703 of the Postal Accountability and Enhancement Act, Pub. L. 109-435, 120 Stat. 3198 (2006) requires that when promulgating new or revised regulations under section 3633, the Commission “shall take into account” Federal Trade Commission recommendations about the net economic effects of laws that apply to the United States Postal Service, and subsequent relevant events.

However, the proposed rules in this instance do not trigger the requirement to consider the net economic effect because the rules are a conforming change required by law. Section 3622(c) requires that costs must be attributed when there is a reliably identified causal relationship that links costs to a class or type of mail service. *See* 39 U.S.C. 3622(c). In Order No. 3506, the Commission found that there were additional costs that satisfied the requirements of section 3622(c), and, therefore, must be attributed. *See* Order No. 3506 at 61-62. Pursuant to section 3622(c), these costs must therefore be attributed to all products, including competitive products. This change in attribution requires conforming changes in 39 CFR part 3015 that are identified in this Notice. Because the rule changes are required by law, any consideration of the “net economic effect” recommendations identified in uncodified section 703 would be moot. Additionally, the Commission discusses the inapplicability of uncodified section 703 to UPS Proposals One and Two in Order No. 3506. Order No. 3506 at 117-120.

The Commission notes, notwithstanding uncodified section 703’s applicability, that this change in attribution results in an improved, more complete, or more accurate measure of attributable costs as defined by section 3622(c), and represents an improvement in the attribution of costs as required by section 3652(e). *See* Order No. 3506 at 122 n.152. The conforming changes identified in this Notice facilitate improved attribution and therefore reduce potential economic distortions.

competitive product rates; for market dominant products, it is only one of many factors the Commission considers when regulating market dominant rates. See 39 U.S.C. 3633 (a)(2); 39 CFR 3015.7(b); 39 U.S.C. 3622(c).

Historically, volume-variable costs and product-specific costs together totaled attributable costs, as the Commission found both volume-variable and product-specific costs are reliably identifiable and causally related to products pursuant to statute.⁵ All other costs are currently classified as institutional and are not attributed to specific products. Order No. 3506 at 10. Institutional costs include common fixed costs and inframarginal costs. *Id.* Inframarginal costs are variable costs that do not vary *directly* with volume. *Id.* (*emphasis added*).

While the Commission found that inframarginal costs are causally related to products, it determined inframarginal costs cannot be reliably identified, which is a necessary component of cost attribution. Order No. 3506 at 56. However, the Commission found that a portion of inframarginal costs (those inframarginal costs calculated as part of a product's incremental cost) are reliably identifiable and can be linked to products. Order No. 3506 at 61. Therefore, pursuant to Order No. 3506, attributable costs must also include those inframarginal costs calculated as part of a competitive product's incremental costs (in addition to a product's volume-variable costs and product-specific fixed costs). It is this change in the description of attributable costs that requires clarification of some attributable cost references in title 39 of the CFR.

III. PROPOSED RULES

The rules requiring conforming or clarifying changes in this notice of proposed rulemaking are §§ 3015.7, 3060.10, and 3060.21.

⁵ Docket No. R74-1, Chief Administrative Law Judge's Initial Decision on Postal Rate and Fee Increases Volume I, May 28, 1975, at 76. See *generally* at *id.* at 76-145; see *also* Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2015, July 6, 2016, "PREF-15" at i; Appendix H, at H-1; Docket No. R83-1, Opinion and Recommended Decision on E-COM Rate and Classification Changes, February 24, 1984, at 186.

Proposed § 3015.7(a) provides that when incremental cost data are unavailable to test for cross-subsidies by market dominant products, the Commission will use volume-variable costs and product-specific costs, as well as causally related, group-specific costs, to test for cross-subsidies. This proposed section removes the “attributable costs” phrase currently described as the alternative test when incremental costs are not available. The proposed rule is intended to provide a refined explanation of the alternative test for cross-subsidization by market dominant products after the Commission found in Order No. 3506 that some incremental costs (those inframarginal costs calculated as part of a competitive product’s incremental costs) should be included as part of attributable costs. Order No. 3506 at 61-62, 123-124.

Proposed § 3015.7(b) includes the updated description of attributable costs to include those inframarginal costs calculated as part of a competitive product's incremental costs, as well as volume-variable costs and product-specific costs. Order No. 3506 at 62. The proposed rule is intended to provide a clear description of which costs should be attributed to competitive products pursuant to the Commission’s findings in Order No. 3506. In addition, proposed rule § 3015.7(b) signifies these three costs not only comply with the description of attributable costs found in 39 U.S.C. 3631(b), but are the costs relevant to the Commission’s evaluation of the Postal Service’s compliance with part 3015.

Proposed §§ 3060.10(a) and 3060.21 both make conforming changes to the description of attributable costs, in each section, to include those inframarginal costs calculated as part of a competitive product's incremental costs, along with volume-variable costs and product-specific costs pursuant to Order No. 3506.

While no other rules in title 39 require revisions as a result of the Commission’s Order No. 3506, the Commission’s findings concerning the use a product’s incremental costs (the sum of volume-variable costs, product-specific costs, and those inframarginal costs calculated as part of a product's incremental costs) to calculate attributable costs

applies to any reference of attributable costs in title 39 unless otherwise indicated by the rules. See *generally* Order No. 3506.

IV. COMMENTS REQUESTED

Interested persons are invited to provide written comments concerning the proposed rule. Comments are due no later than 30 days after the date of publication of this notice in the *Federal Register*. All comments and suggestions received will be available for review on the Commission's website, <http://www.prc.gov>.

Pursuant to 39 U.S.C. 505, Kenneth E. Richardson is appointed to serve as an officer of the Commission (Public Representative) to represent the interests of the general public in the above-captioned docket.

V. ORDERING PARAGRAPHS

It is ordered:

1. Docket No. RM2016-13 is established for the purpose of receiving comments on the proposed change to parts 3015 and 3060, as discussed in this Order.
2. Interested persons may submit comments no later than 30 days from the date of the publication of this notice in the *Federal Register*.
3. Pursuant to 39 U.S.C. 505, Kenneth E. Richardson is appointed to serve as the Public Representative in this proceeding.

4. The Secretary shall arrange for publication of this Order in the *Federal Register*.

By the Commission.

Stacy L. Ruble
Secretary

List of Subjects

39 CFR Part 3015

Administrative practice and procedure, Postal Service.

39 CFR Part 3060

Administrative practice and procedure, Reporting and recordkeeping requirements.

For the reasons discussed in the preamble, the Commission proposes to amend chapter III of title 39 of the Code of Federal Regulations as follows:

Part 3015—REGULATION OF RATES FOR COMPETITIVE PRODUCTS

1. The authority citation of part 3015 continues to read as follows:

Authority: 39 U.S.C. 503; 3633.

2. Amend § 3015.7 by revising paragraph (a) and (b) to read as follows:

§ 3015.7 Standards for compliance.

* * * * *

(a) Incremental costs will be used to test for cross-subsidies by market dominant products of competitive products. To the extent that incremental cost data are unavailable, the Commission will use the sum of competitive products' volume-variable costs and product-specific costs supplemented to include causally related, group-specific costs to test for cross-subsidies.

(b) Each competitive product must recover its attributable costs as defined in 39 U.S.C. 3631(b). Pursuant to 39 U.S.C. 3631(b), the Commission will use a competitive product's incremental costs, which is the sum of volume-variable costs, product-specific costs, and those inframarginal costs calculated as part of a competitive product's incremental costs, to calculate attributable costs.

* * * *

Part 3060—ACCOUNTING PRACTICES AND TAX RULES FOR THE THEORETICAL COMPETITIVE PRODUCTS ENTERPRISE

3. The authority citation of part 3060 continues to read as follows:

Authority: 39 U.S.C. 503; 2011, 3633, 3634.

4. Amend § 3060.10 by revising paragraph (b)(1) to read as follows:

§ 3060.10 Costing.

* * * * *

(b) * * *

(1) Attributable costs, including volume-variable costs, product-specific costs, and those inframarginal costs calculated as part of a competitive product's incremental costs; and

(2) * * *

5. Amend § 3060.21 by revising Table 1—Competitive Products Income Statement—PRC Form CP-01 to read as follows:

§ 3060.21 Income report.

* * * * *

Table 1—Competitive Products Income Statement—PRC Form CP-01

[\$ in 000s]

	FY 20xx	FY 20xx-1	Percent change from SPLY	Percent change from SPLY
Revenue:	\$x,xxx	\$x,x xx	xxx	xx.x
(1) Mail and Services Revenues	xxx	xxx	xx	xx.x
(2) Investment Income	x,xx	x,xxx	xxx	xx.x
(3) Total Competitive Products Revenue				
Expenses:	x,xxx			
(4) Volume-Variable Costs	x,xxx	x,xxx	xxx	xx.x
(5) Product Specific Costs	x,xxx	x,xxx	xxx	xx.x
(6) Incremental Inframarginal Costs	x,xxx	x,xxx	xxx	xx.x
(7) Total Competitive Products Attributable Costs	x,xxx	x,xxx	xxx	xx.x
(8) Net Income Before Institutional Cost Contribution	x,xxx	x,xxx	xxx	
(9) Required Institutional Cost Contribution	x,xxx	x,xxx	\$xxx	x.x.x
(10) Net Income (Loss) Before Tax	x,xxx	x,xxx	\$xxx	xx.x
(11) Assumed Federal Income Tax	x,xxx	x,xxx	\$xxx	xx.x
(12) Net Income (Loss) After Tax	x,xxx	x,xxx	\$xxx	xx.x

Line (1): Total revenues from Competitive Products volumes and Ancillary Services.

Line (2): Income provided from investment of surplus Competitive Products revenues.

Line (3): Sum total of revenues from Competitive Products volumes, services, and investments.

Line (4): Total Competitive Products volume-variable costs as shown in the Cost and Revenue Analysis (CRA) report.

Line (5): Total Competitive Products product-specific costs as shown in the CRA report.

Line (6): Inframarginal costs calculated as part of total Competitive Products incremental costs.

Line (7): Sum total of Competitive Products costs (sum of lines 4, 5, and 6).

Line (8): Difference between Competitive Products total revenues and attributable costs (line 3 less line 6).

Line (9): Minimum amount of Institutional cost contribution required under 39 CFR 3015.7 of this chapter.

Line (10): Line 8 less line 9.

Line (11): Total assumed Federal income tax as calculated under 39 CFR 3060.40.

Line (12): Line 10 less line 11.